

Office of Chief Counsel
Internal Revenue Service

memorandum

CC:LM:CTM:LA:2:TL-N-7333-00
RHSchorman

date:

to: Ed Finley, Revenue Agent
Team 1748, Santa Barbara, California

from: ROBERT H. SCHORMAN, JR.
Attorney (LMSB)

subject:

TIN:

Year:

TIN:

Year:

DISCLOSURE STATEMENT

This advice constitutes return information subject to I.R.C. § 6103. This advice contains confidential information subject to attorney-client and deliberative process privileges and if prepared in contemplation of litigation, subject to the attorney work product privilege. Accordingly, the I.R.S. recipient of this document may provide it only to those persons whose official tax administration duties with respect to this case require such disclosure. In no event may this document be provided to I.R.S. personnel or other persons beyond those specifically indicated in this statement. This advice may not be disclosed to taxpayers or their representatives.

This advice is not binding on the I.R.S. and is not a final case determination. Such advice is advisory and does not resolve Service position on an issue or provide the basis for closing a case. The determination of the Service in the case is to be made through the exercise of the independent judgment of the office with jurisdiction over the case.

ISSUES

1. Who is authorized to sign a consent to extend the six year statute of limitations for assessment regarding the taxable year [REDACTED] on behalf of [REDACTED], Deceased.
2. Who are the transferees of [REDACTED].

BRIEF ANSWERS

1. [REDACTED], as the surviving spouse of [REDACTED], may sign a Form 872 Consent to Extend the Time to Assess Tax for the taxable year ending December 31, [REDACTED] on behalf of [REDACTED], Deceased.
2. The transferees of the [REDACTED] are the [REDACTED] and the [REDACTED]. [REDACTED] is the trustee of both trusts.

FACTUAL SUMMARY

The Service has examined [REDACTED]'s (hereinafter "[REDACTED]") [REDACTED] Form 1120 and the Service has proposed adjustments. [REDACTED] was a manufacturer and distributor of [REDACTED] under the [REDACTED] brand. In [REDACTED] sold its business assets to [REDACTED] for [REDACTED] dollars and invested the net proceeds in tax exempt bonds. The sales agreement between [REDACTED] and [REDACTED] provided that the buyer would not assume or be liable for the income tax liabilities of [REDACTED]. [REDACTED] converted from a C corporation to an S Corporation in [REDACTED]. On [REDACTED], [REDACTED] was liquidated. Its assets were divided in liquidation [REDACTED]% to the [REDACTED] and [REDACTED]% to the [REDACTED].

The stock of [REDACTED] was originally owned by [REDACTED]. [REDACTED] created the [REDACTED], a revocable inter vivos trust, on [REDACTED]. They were the trustees of the trust. The assets placed in the trust included the stock of [REDACTED]. Some time after the creation of the trust, [REDACTED] became incompetent due to [REDACTED] and [REDACTED] was appointed by the court as his conservator. [REDACTED] died on [REDACTED]. The [REDACTED] provided that on the death of the first spouse to die, the assets of the trust would be divided into a surviving spouse's trust, an exemption trust and a marital trust. On [REDACTED]'s death [REDACTED]% of the stock in [REDACTED] was allocated to the [REDACTED] (the surviving spouse's trust) and the other [REDACTED]% of the [REDACTED] stock was allocated to the [REDACTED].

[REDACTED]. Upon [REDACTED]'s death, [REDACTED] became the sole trustee of the [REDACTED]. She was also the trustee of the [REDACTED] and [REDACTED].

[REDACTED] was also named in her husband's will as the executor. Due to the trust arrangements, [REDACTED]'s estate was never probated and [REDACTED] was never appointed by a court as the personal representative of the estate. The [REDACTED] joint [REDACTED] Form 1040 is only open on the six year statute of limitations where there is a 25% omission of income pursuant to I.R.C. § 6501(e). As a result of adjustments to [REDACTED] and a related company, the Service is proposing adjustments to the [REDACTED] taxable year.

ANALYSIS

I. Statute Extension

No cases or other authorities specifically address the question of who can sign a waiver of the statute of limitations where there is no court appointed administrator, executor or other personal representative of the estate. However, I.R.C. § 6012(b)(1) provides that a decedent's income tax return "shall be made by his executor, administrator or other person charged with the property of such decedent." See also Treas. Reg. § 1.6012-3(b)(1). Section 6012(b)(1) authorizes [REDACTED], as the person charged with the property of the decedent, to make [REDACTED]'s final income tax return. While there is no authority directly addressing the issue, by implication we conclude that [REDACTED] is also authorized under this section to sign a Form 872 Consent to Extend the Time to Assess Tax on behalf of [REDACTED], deceased for the [REDACTED] taxable year. The signature space on the Form 872 should read "[REDACTED], Deceased by [REDACTED], Surviving Spouse."

II. Transferees

I.R.C. § 6901 contains the statutory framework for assessment and collection of the tax against a transferee of property received from a taxpayer having unpaid tax liabilities. Section 6901 authorizes the assessment of transferee liability, at law or in equity, against a transferee of property for the tax liability of another taxpayer subject to the same provisions and limitations as in the case of the taxes with respect to which the liabilities were incurred. Section 6901 merely provides a secondary method for enforcing the existing liability of the transferor; it does not create a separate liability. Patricia E. Mysse, 57 T.C. 680, 700-701 (1972); C. B. C. Super Markets, Inc.,

54 T.C. 882, 897-898 (1970). The questions of the existence and extent of the transferee's liability for the transferor's obligations must be determined in accordance with applicable state law, see, Commissioner v. Stern, 357 U.S. 39, 45 (1958), and the burden of showing that a person is liable as a transferee of property rests with the Commissioner, I.R.C. § 6902(a). Thus, the transferee liability statute, I.R.C. § 6901, is primarily a collection method. The property involved in this case was transferred in California and therefore California law is applicable. Adams v. Commissioner, 70 T.C. 373, 390 (1978), aff'd without published opinion, 688 F.2d 815 (2d Cir. 1982).

A transferee is retroactively liable for a transferor's unpaid taxes in the year of transfer and prior years, and additions and interest in connection therewith, to the extent of the assets received by the transferee even though the transferor's tax liability was unknown at the time of the transfer. Delpit v. Commissioner, T.C. Memo. 1991-147.

In this case, upon liquidation, assets of [REDACTED] were directly transferred to the shareholders of [REDACTED], the [REDACTED] and the [REDACTED]. These trusts are the transferees of [REDACTED]. The trusts may be liable as transferees under California's fraudulent conveyance law and/or corporation law.

a. Liability Under the Uniform Fraudulent Transfer Act

Since the transfer occurred in [REDACTED], the applicable California fraudulent conveyance law is the Uniform Fraudulent Transfer Act (UFTA) which was adopted by California in 1986 and which applies to transfers occurring after January 1, 1987. Cal. Civ. Code § 3439.12. California's version of the UFTA is codified at Cal. Civ. Code §§ 3439 et. seq.

California's UFTA allows transfers to be set aside for either actual fraud or constructive fraud. It specifically allows both present and future creditors (i.e., creditors whose claims arose after the transfer) to assert both actual and constructive fraud under Cal. Civ. Code § 3439.04.

Cal. Civ. Code § 3439.04 provides as follows:

"A transfer made or obligation incurred by a debtor is fraudulent as to a creditor, whether the creditor's claim arose before or after the transfer was made or the obligation was incurred, if the debtor made the transfer or incurred the obligation as follows:

- (a) With actual intent to hinder, delay, or defraud any creditor of the debtor.
- (b) Without receiving a reasonably equivalent value

in exchange for the transfer or obligation, and the debtor:

- (1) was engaged or was about to engage in a business or a transaction for which the remaining assets of the debtor were unreasonably small in relation to the business or transaction; or
- (2) Intended to incur, or believed or reasonably should have believed that he or she would incur, debts beyond his or her ability to pay as they became due."

Cal. Civ. Code § 3439.04(a) concerns transfers that are referred to as actual fraud and Cal. Civ. Code § 3439.04(b) concerns transfers that are referred to as constructive fraud.

In order to establish transferee liability under a theory of constructive fraud (Cal. Civ. Code § 3439.04(b)), the Commissioner must show:

- (1) That the Commissioner had a creditor's claim against [REDACTED] that arose either before or after the transfer was made;
- (2) that [REDACTED] transferred property to the trusts;
- (3) that the trusts did not give [REDACTED] reasonably equivalent value for the transferred property; and
- (4) that [REDACTED] was left with inadequate assets to pay its tax liabilities or [REDACTED] reasonably should have believed it would incur debts, such as tax liabilities, beyond its ability to pay as they became due.

The Commissioner must establish by a preponderance of the evidence that the transfers to the trusts were constructive fraud under California's UFTA. Lioudas v. Sahadi, 19 Cal.3d 278, 562 P.2d 316, 137 Cal. Rptr. 635 (1977); Whitehouse v. Six Corporation, 40 Cal.App.4th 527, 48 Cal. Rptr.2d 600 (1995).

Based on the information you have provided and assuming that the proposed adjustments are sustained against [REDACTED], the trusts could be held liable as transferees of [REDACTED] under the California UFTA. If the proposed adjustments are sustained, the Commissioner will have a claim for tax deficiencies against [REDACTED]. Upon the complete liquidation of [REDACTED] in [REDACTED], the corporation transferred all of its assets to the trusts. The deemed surrender of stock by the trusts would not constitute adequate consideration since the stock has no value independent of the corporate assets. Since the corporation has no more assets after complete liquidation, the stock would be valueless. See Delpit v. Commissioner, *supra*. After the complete liquidation, [REDACTED] had no assets from which to pay a tax liability.

b. Liability Under the California Corporations Code

Since the Service must look to state law in order to establish transferee liability under I.R.C. § 6901 pursuant to Commissioner v. Stern, supra, another possible state law basis for transferee liability of the trusts is found in the California Corporations Code.

California Corporations Code section 2009 provides as follows:

"(a) Whenever in the process of winding up a corporation any distribution of assets has been made, otherwise than under an order of court, without prior payment or adequate provision for payment of any of the debts and liabilities of the corporation, any amount so improperly distributed to any shareholder may be recovered by the corporation. Any of such shareholders may be joined as defendants in the same action or brought in on the motion of any other defendant.

(b) Suit may be brought in the name of the corporation to enforce the liability under subdivision (a) against any or all shareholders receiving the distribution by any one or more creditors of the corporation, whether or not they have reduced their claims to judgment.

(c) Shareholders who satisfy any liability under this section shall have the right of ratable contribution from other distributees similarly liable. Any shareholder who has been compelled to return to the corporation more than the shareholder's ratable share of the amount needed to pay the debts and liabilities of the corporation may require that the corporation recover from any or all of the other distributees such proportion of the amounts received by them upon the improper distribution as to give contribution to those held liable under this section and make the distribution of the assets fair and ratable, according to the respective rights and preferences of the shares, after payment or adequate provision for payment of all the debts and liabilities of the corporation.

(d) As used in this section, "process of winding up" includes proceedings under Chapters 18 and 19 and also any other distribution of assets to shareholders made in contemplation of termination or abandonment of the corporate business."

California Corporations Code section 2009 provides that a creditor may bring an action directly against the corporation's shareholders in the corporation's name, when there has been a distribution of assets to the shareholders without provision for payment of debts or liabilities.

California Corporations Code section 2011 provides in pertinent part as follows:

"(a) (1) Causes of action against a dissolved corporation, whether arising before or after the dissolution of the corporation, may be enforced against any of the following:

(A) Against the dissolved corporation, to the extent of its undistributed assets, including, without limitation, any insurance assets held by the corporation that may be available to satisfy claims.

(B) If any of the assets of the dissolved corporation have been distributed to shareholders, against shareholders of the dissolved corporation to the extent of their pro rata share of the claim or to the extent of the corporate assets distributed to them upon dissolution of the corporation, whichever is less.

A shareholder's total liability under this section may not exceed the total amount of assets of the dissolved corporation distributed to the shareholder upon dissolution of the corporation.

(2) Except as set forth in subdivision (c), all causes of action against a shareholder of a dissolved corporation arising under this section are extinguished unless the claimant commences a proceeding to enforce the cause of action against that shareholder of a dissolved corporation prior to the earlier of the following:

(A) The expiration of the statute of limitations applicable to the cause of action.

(B) Four years after the effective date of the dissolution of the corporation.

(3) As a matter of procedure only, and not for purposes of determining liability, shareholders of the dissolved corporation may be sued in the corporate name of the corporation upon any cause of action against the corporation. This section does not affect the rights of the corporation or its creditors under Section 2009, or the rights, if any, of creditors under the Uniform Fraudulent Transfer Act, which may arise against the shareholders of a corporation.

(4) This subdivision applies to corporations dissolved on and after January 1, 1992. Corporations dissolved prior to that date are subject to the law in effect prior to that date."

California Corporations Code section 2011 is by its own terms procedural in nature and does not affect creditor's rights

conferred by section 2009 or the UFTA. However, it limits the liability of a shareholder to the shareholder's pro rata share of a claim or to the extent of the corporate assets distributed to the shareholder upon dissolution of the corporation. Any cause of action against a shareholder of a dissolved corporation must be commenced before the earlier of the expiration of the limitations period applicable to the cause of action or within four years after the effective date of the dissolution of the corporation.

In the instant case, [REDACTED] was liquidated on [REDACTED]. Thus, the four year statute of limitations contained in California Corporations Code section 2011(a)(2) expired on [REDACTED]. The transferees could argue that the Service would be barred by the statute of limitations from proceeding against them under California Corporations Code sections 2009 and 2011. However, we believe that this argument lacks merit.

Notwithstanding a state law statute of limitations argument, the United States is generally not subject to state statutes of limitations. While the Internal Revenue Service relies on state law to establish transferee liability, the government's underlying right to collect money derives from federal law. Federal law sets the procedural limits, such as statutes of limitation, on the government's federal law rights. Bresson v. Commissioner, 213 F.3d 1173 (9th Cir. 2000). Thus, in Bresson, the United States Court of Appeals for the Ninth Circuit held that a claim extinguishment provision in the California UFTA (which the Court referred to as a "dressed up statute of limitations") did not bar the government from asserting transferee liability where the government's claim was timely under the federal limitations period of I.R.C. § 6901(c).

Under the reasoning of Bresson, the government probably could proceed against the trusts as transferees under California Corporations Code sections 2009 and 2011. However, California Corporations Code sections 2009 and 2011 do not add any rights not already available to the Service under the UFTA and are discussed here only as a secondary theory of state law liability.

c. Contractual Transferee Liability

Transferee liability at law can also arise when two parties enter into a contract that one party will be responsible for the other's tax liability. Kamen Soap Products Co., Inc. v. Commissioner, T.C. Memo. 1954-169, aff'd, 230 F.2d 565 (2d Cir. 1956). In the instant case, [REDACTED] specifically declined to assume the tax liabilities of [REDACTED] in the sales agreement. Thus, [REDACTED] would not be a transferee of [REDACTED].

d. Procedural Aspects of Transferee Liability

The Service may assess the liability of an initial transferee within 1 year after the period to assess tax against the transferor expires. I.R.C. § 6901(c)(1). An extension of the time to assess against the transferor, extends the period to assess against the transferee. See, U.S. v. The Mission Company, et al., 57-2 U.S.T.C. ¶9782 (N.D.CA. 1957) aff'd per curiam sub nom. Dardi, 252 F.2d 670 (9th Cir. 1958).

It should be noted that since transferee liability is a collection method, it is not resorted to until the liability of the transferor has been established and the Service has been unable to collect against the transferor or collection efforts against the transferor would be futile. Procedurally, a Revenue Officer will investigate and prepare a report concerning transferee liability after collection efforts against the primary obligor prove unsuccessful. The Service will then issue a Notice of Transferee Liability to the transferees which operates in the same manner as a Statutory Notice of Deficiency.

ROBERT H. SCHORMAN, JR.
Attorney (LMSB)

APPROVED:

MICHAEL P LACKNER
Associate Area Counsel
LMSB